PENSION MANAGEMENT OVERSIGHT COMMISSION

Legislative Services Agency
200 West Washington Street, Suite 301
Indianapolis, Indiana 46204-2789
Tel: (317) 232-9588 Fax: (317) 232-2554

MEETING MINUTES[1]

Meeting Date:	**October 4, 2000**
Meeting Time:	**10:00 A.M.**
Meeting Place:	**State House, 200 W. Washington St., Room 233**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**3**

Members Present: **Rep. Thomas Kromkowski, Chairperson; Rep. Ron Liggett; Rep. Lawrence Buell; Sen. Thomas Weatherwax; Sen. Larry Lutz; Mr. William Gettings, Jr.**

Members Absent: **Rep. Richard Mangus; Sen. Joseph Harrison; Steve Meno; Claude Davis; Connie Lux; Sen. Allie Craycraft.**

Representative Thomas Kromkowski, Chair of the Commission, called the meeting to order shortly after 10:00 a.m.

I. 401(a) Accounts for Converting Unused Accrued Leave

Representative Kromkowski recognized Mr. Dan Novreske, State Budget Agency Deputy Director, for a discussion concerning the possibility of using 401(a) accounts for converting unused accrued leave of state employees. Mr. Novreske began by explaining that state

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employees have $177 million of accumulated leave time, and that many employees will not use all of their accumulated time. He noted that the upon an employee's separation from service, the state will pay for up to 225 hours of unused vacation time.

Mr. Novreske then described the Section 125 cafeteria plan that was established in 1999 for state employees retiring after July 1, 1999. He explained that the funding of these accounts, which may be up to a maximum of $5,000 per person, is done on a post-retirement basis. He said that the State Budget Agency was considering the possibility of allowing state employees to convert unused leave time into amounts that will be deposited in a 401(a) qualified plan. Mr. Novreske said this approach would allow employees who do not use all of their leave time to convert those days on a pre-retirement, tax-deferred basis. He explained that an employee would be able to self-direct the investment of the employee's account balance. (See Exhibit A, material distributed by Mr. Novreske.)

Mr. Novreske said that it will take additional study to determine whether such a 401(a) plan would replace the current cafeteria plan for unused leave time, or whether the 401(a) plan would exist in addition to the cafeteria plan.

In response to a question from Senator Tom Weatherwax, Mr. Novreske said that state employees would each year be given the opportunity to "sell back" to the state their unused leave time that is in excess of thirty days. Representative Kromkowski asked what rate the state would pay for the days, and Mr. Novreske replied that it might be 50% of the employee's pay for that day.

Mr. David Larsen of the Indiana State Employees Association stated that under such a plan the amount paid by the state for unused days should not be discounted. Ms. Cordelia Lewis of AFSCME stated that she would review the proposal.

II. Indiana Deferred Compensation Plan

Representative Kromkowski then recognized Mr. Eugene Thompson, President of Indiana Deferred Compensation Plan, Inc. (IDCP). Mr. Thompson began by noting that IDCP has been the service manager of the Indiana Public Employee Deferred Compensation Plan since the plan's inception in 1981. He stated that as of June 30, 2000, there were 29,000 state and local government employees participating in the plan, and that these employees had accumulated assets of $471 million.

Mr. Thompson stated that in 1998 the statute governing the deferred compensation plan was amended to create a five member deferred compensation committee, appointed by the State Board of Finance, and that this committee serves as the plan's trustees. He explained that the State Auditor is the administrator of the plan.

Mr. Thompson said that in 1999 the General Assembly approved the establishment of a 401(a) defined contribution plan that would allow employers to match a portion of employees' contributions. He stated that during the first eight months since the inception of the matching benefit, 8,000 additional state employees have enrolled in the deferred compensation plan. He noted that 60% of state employees currently participate in the plan, and that the state contributes approximately $8 million annually into the employee match accounts.

Mr. Thompson noted that the deferred compensation plan and other supplemental retirement programs are operated independently of the Public Employees' Retirement Fund (PERF) and the Teachers' Retirement Fund (TRF). He suggested that the Commission might want to consider integrating Indiana's retirement benefit structure in order to make it more responsive to members.

Mr. Thompson also briefly described pending federal legislation that includes various proposed changes related to retirement plans. (See Exhibit B, Mr. Thompson's written testimony.)

III. Fiscal Information Concerning Police and Firefighters' Pension Based on Actual Salary

Mr. Doug Todd of McCready and Keene, Inc., actuaries for PERF, provided information to the Commission on the cost of basing police and firefighter pensions under the 1977 Fund on actual salaries, rather than on salaries of first class officers. Mr. Todd stated that it is somewhat difficult to give such an estimate, because PERF does not receive individual salary information on members of the 1977 Fund. He said that after sampling a number of cities, he estimated that moving to a salary based on a five-year average of high salary would increase the 1977 Fund's actuarial accrued liability by about $39 million. He estimated that such a change would require an increase of approximately $8.9 million in annual funding by municipalities (from $74 million to $82.9 million).

In response to a question from Senator Larry Lutz, Mr. Todd explained that the contribution rates for employers and employees would not change (21% and 6%, respectively), but that these contributions would be based on actual salaries, which in most cases would be a higher amount than the first class officer salary. (See Exhibit C, Mr. Todd's cost estimate.)

IV. Investment of Annuity Savings Account Contributions in Annuities Provided by Additional Licensed Insurers

Representative Kromkowski next recognized Mr. Don VanPutten of American General VALIC. Mr. VanPutten stated that he had attended the Commission's previous meeting, where it had addressed the issue of what form of benefit should be made available to a retired PERF member who becomes reemployed in a PERF-covered position. Mr. VanPutten suggested that the Commission should consider the use of a defined contribution plan in such a situation. He said that studies show that most individuals change jobs at least eight times during their careers. He stated that defined contribution plans have the advantage of budget predictability, because of the nature of their "up-front" funding, and that these plans could be used to reduce liability under a defined benefit system. Mr. VanPutten also cited the immediate vesting and portability features of defined contribution plans. He stated that 46 states, including Indiana, have some form of defined contribution plan.

Mr. VanPutten suggested that the Commission should consider: (1) using defined contribution plans as an alternate to defined benefit plans; (2) using defined contribution plans as a pension supplement for extended service or continued service; and (3) using private vendors for such plans.

V. School Corporation Retirement Plan Conversion

Representative Kromkowski then recognized Senator Robert Jackman, who explained that a combination of factors have created financial problems for school corporations with regard to local severance and retirement plans. He stated that he hoped the Commission would address the issue.

Mr. Michael Shreve, Business Manager of Shelbyville Central Schools (SCS), began by noting that most school corporations have problems with their local retirement plans. Mr. Shreve stated that in 1997, SCS's early retirement liability for teachers who could retire over the next five years was over $2.6 million (not including severance payments). Mr. Shreve stated that SCS decided to freeze the amount of teacher retirement pay that it was obligated to pay retiring teachers, and that it then established a 401(a) defined contribution plan into which SCS contributed a $250 match for teacher contributions into their 403(b) tax sheltered annuity plans. He explained a transition plan was implemented that would offset the total liability to retiring teachers by the amounts in their 401(a) accounts. According to Mr. Shreve, teachers hired after July 1, 1999, will not be eligible for any severance or early retirement pay from SCS, other than the balance in their 401(a) plans. Mr. Shreve stated that the average cash balance for SCS for the past four years has been $2.3 million, but that its current liability for teachers that could retire over the next five years is over $3.9 million. (See Exhibit D, Mr. Shreve's written testimony and supporting documentation.)

Representative Larry Buell asked if this problem is similar to the problem addressed legislatively during the 2000 Session for South Bend schools. Senator Jackman answered that it is similar, and that it would be best to address the issue statewide rather than develop separate approaches for each school corporation. Representative Buell asked if the approach taken during the past session could be expanded so that it would have statewide applicability. Senator Jackman stated that this approach would require schools to assume more debt. Mr. Roger Thornton of the Indiana Association of Public School Superintendents explained that the approach taken during the past session would only work with school corporations that have enough excess capacity in their capital projects fund and transportation fund so that any bonds issued could be paid without any increase in taxes. Senator Jackman stated that this approach would not work for all school corporations, and he commented that he was looking to the Commission for direction on the issue.

Mr. Thornton explained how many of the early retirement packages adopted by school corporations in the 1980s were designed to give lower incentives to eligible persons as they got older. He stated that courts have held a number of these plans to violate the federal Age Discrimination in Employment Act (ADEA). Mr. Thornton said that the Internal Revenue Service has ruled under other types of early retirement plans an employee may be taxed on the benefit at the time the employee becomes eligible to claim it, even if the employee does not claim the benefit immediately. He commented that the problems did not result from bad bargaining or lack of good faith, but instead from court decisions and IRS rulings. He urged the Commission to consider the possibility of using state funds to assist schools that have found themselves with plans that run afoul of the ADEA or IRS tax rules.

Mr. Thornton also briefly described two other pension-related issues facing school corporations: (1) the unfunded liability of the new TRF fund is increasing, because the liabilities of teachers in the old TRF fund who are rehired are transferred to the new fund, but no assets are transferred to fund those liabilities; and (2) the Department of Education should be allowed to employ retired teachers without those teachers' pensions being affected. In response to questions from Senator Weatherwax and Mr. Bill Gettings, Mr. Thornton stated that it may be the case that growing school districts are experiencing the most difficulty from transfer of liabilities from the old TRF fund.

Ms. Denise Jones, of Gabriel, Roeder, Smith, and Co., actuaries for TRF, stated that when liability for a reemployed teacher is transferred is to the new TRF fund, there are no assets other than employee contributions available to transfer along with the liability.

VI. Fiscal Impact of Minimum Benefit for PERF and TRF

Representative Kromkowski then recognized Mr. Todd of McCready and Keene. Mr. Todd explained that he had prepared a fiscal impact analysis for a proposal to provide a minimum monthly benefit of $300 or $400 to PERF members who retire at normal retirement age with the normal form of benefit (with other benefit options actuarially adjusted). Mr. Todd noted that approximately 2/3 of PERF members currently receive benefits of less than $400 per month.

He estimated that implementing a $400 minimum monthly benefit would increase PERF's unfunded liability by $572 million and would increase the payroll percentage cost by approximately 2.0%. According to Mr. Todd, implementing a $300 minimum monthly benefit would increase PERF's unfunded liability by $289 million and would increase the payroll percentage cost by approximately 1.1%. (See Exhibit E.)

Ms. Jones of Gabriel, Roeder, Smith, and Co., explained that the cost increases for TRF if such minimum benefits were implemented are not as great, because the TRF average benefit is much higher than the average PERF benefit, and therefore fewer members would be affected by these proposed minimums. She stated that the average monthly pensions for members electing straight life forms of benefits at normal retirement age are $851 (old fund) and $1,124 (new fund). Ms. Jones estimated that a $400 minimum would add $45.4 million to TRF's unfunded liability and increase the payout in the first year by $5.5 million. She estimated that a $300 minimum would add $23.5 million to TRF's unfunded liability and increase the payout in the first year by $2.7 million. (See Exhibit F.)

Commission member William Gettings noted that a significant number of members were choosing the straight life benefit option, and were not providing for survivor benefits. He suggested that the actuaries might consider what impact would result from changing the actuarial reduction factors so that it would be less costly for members to choose a benefit option that included survivor benefits.

VII. Judges' Retirement Fund Issues

Ms. Sarah Burkman, attorney for the Commission, then briefly described a preliminary draft of proposed legislation concerning judges' pensions. She explained that PD 3204 would do the following: (1) provide that a person serving as a full-time magistrate on July 1, 2001, may make an election to become a member of the judges' 1985 benefit system, effective January 1, 2002; (2) provide that a person who begins serving as a full-time magistrate after July 1, 2001, shall be a participant in the judges' 1985 benefit system, effective January 1, 2002; (3) allow full-time magistrates who are participants in the 1985 benefit system of the judges' retirement fund to purchase service credit at full actuarial cost for certain prior service; and (4) beginning in 2002, require the monthly benefits payable to participants, survivors, and beneficiaries under the 1985 benefit system of the judges' retirement fund to be increased by the same percentages and under the same conditions as monthly benefits are increased for members of PERF. Ms. Burkman noted that the last provision, concerning cost-of-living adjustments, should be changed to have a July 1, 2001, effective date so that it would coincide with the beginning of a budget cycle. (See Exhibit G, PD 3204.)

Mr. Tom Fruechtenicht testified that the Commission had previously recommended the same proposal. Judge Vadic, representing the Indiana Judges Association, also noted that the Commission had previously recommended the same legislation, and she asked the Commission to again support the proposal.

VIII. Prosecuting Attorneys Retirement Fund Issues

Ms. Burkman then briefly described the provisions of PD 3243, concerning pensions for prosecuting attorneys. According to Ms. Burkman, PD 3243 would: (1) beginning in 2002, require the monthly benefits payable to participants, survivors, and beneficiaries under the Prosecuting Attorneys Retirement Fund (PARF) to be increased by the same percentages and under the same conditions as monthly benefits are increased for members of PERF; (2) provide that a member of PARF is not required to make contributions to the fund after the member has contributed to the fund for 22 years; (3) reduce from ten to eight the number of years required to vest as a member of PARF; (4) increase the percentages used in computing retirement benefits under PARF; and (5) change the reduction factor for retirement before 65 years of age. Ms. Burkman noted that the first provision, concerning cost-of-living adjustments, should be changed to have a July 1, 2001, effective date so that it would coincide with the beginning of a budget cycle. (See Exhibit H, PD 3243.)

Ms. Deborah Daniels and Prosecutor John Larsen both testified in favor of the proposed legislation, noting that the Commission had supported similar legislation during 1999.

IX. PERF and TRF Administrative Issues

Mr. Ed Gohmann, attorney for the Commission, briefly described the provisions included in PD 3284. According to Mr. Gohmann, this draft would: (1) specify that the additional annuity savings account contributions that may be made by a PERF or TRF member may not exceed 10% of the member's compensation; (2) provide that a governing body of a unit that is participating in PERF is not required to request a survey of the estimated cost of participation, and the PERF board is not required to provide an estimate of the costs of participation, when the unit adopts a resolution or ordinance providing that additional classifications of employees will become members of the fund; (3) specify that an employer may pay all or a part of the annuity savings account contribution for employees (other than state employees) who are members of PERF; (4) provide that persons employed by TRF are members of TRF; (5) provide that even if a firefighter is 36 years of age or older, the firefighter may be reappointed as a member of a department if the firefighter can complete 20 years of service before reaching 60 years of age; and (6) correct cross references to provisions related to police and firefighter disability benefits. (See Exhibit I, PD 3284.)

X. Health Insurance for Retired State Employees

Representative Kromkowski then recognized Mr. Al Gossard, LSA fiscal analyst. Mr. Gossard provided the Commission with an estimate of the fiscal impact of a proposal that would allow certain retired state employees under the age 65 to participate in the group health insurance program provided to active employees, if those retired employees contributed the same premium amount that is paid by active employees. Mr. Gossard noted that under existing law, retired state employees must pay the entire cost of their health insurance in order to participate in the health insurance program.

Mr. Gossard estimated that the net cost to the state would be between $1 million and $7 million annually. In answer to questions from Commission members, Mr. Gossard explained that the costs to the state for paying the employer's share for retirees who are currently participating (and who are currently paying the entire premium) would be approximately $1.1 million annually. He explained that there are approximately 1,200 retirees who are not currently participating in the health insurance program but who would have an increased incentive to participate if the state were to pay the employer's share of the premium. According to Mr. Gossard, depending on the number of these persons who actually begin participating and depending on their claims experience, their net cost to the state could be between $4 million and $10 million annually. Mr. Gossard noted that if: (1) some active employees chose to take early retirement because they would find health insurance more affordable; and (2) they were replaced by lower-salary employees, the state could experience cost-savings from lower salary and fringe benefits. (See Exhibit J, "Estimated Cost of Health Insurance Proposal for Retired State Employees.")

XI. Prescription Drug Coverage for Retired State Employees

Mr. Gossard next provided the Commission with an estimate of the fiscal impact of a proposal to provide pharmaceutical insurance coverage for retired state employees if the retired employees pay the same amounts paid by active employees for such coverage. He estimated the state's share of the cost of such a program to be between $13.8 million and $14.4 million. (See Exhibit K, "Fiscal Impact of Prescription Drug Coverage for Retired State Employees.")

XII. Earnings Limitation for Re-employed PERF and TRF Members

Representative Kromkowski then recognized Mr. Todd, actuary for PERF. Mr. Todd explained that he had prepared a fiscal impact estimate for a proposal that would: (1) allow retirees who are past the Social Security normal retirement age to: (i) continue to receive their original benefit and (ii) accrue additional benefits during their period of reemployment in a PERF-covered or TRF-covered position, based solely on service and compensation in that reemployment period; and (2) provide that PERF or TRF members who retire before normal retirement age would be subject to an earnings limitation if they were reemployed in PERF-covered and TRF-covered positions. Mr. Todd estimated that under such a proposal PERF would experience a $49.9 million increase in its unfunded liability, with a 0.3% increase in cost as a percentage of payroll. (See Exhibit L, "Elimination of Earnings Limitation.")

Representative Kromkowski recognized Ms. Mary Beth Braitman of Ice Miller, outside counsel for PERF and TRF. Mr. Braitman pointed out that at the Commission's previous meeting Mr. Todd had estimated that the cost of not re-imposing any earnings limitation would be approximately 2% of payroll.

Ms. Denise Jones, actuary for TRF, provided an estimate of the fiscal impact that the proposal described by Mr. Todd would have on TRF. She estimated that such a proposal would increase TRF's unfunded liability by approximately $61.7 million, and that it would increase the contribution as a percentage of payroll by 0.12% (old TRF fund) and 0.11% (new TRF fund). See Exhibit M, "Earnings Limitation During Periods of Reemployment.")

XIII. Cafeteria Plan for Retired State Employees

Mr. Gohmann, staff attorney for the Commission, briefly described a proposal concerning the cafeteria plan for retired state employees. According to Mr. Gohmann, PD 3323 would increase from $5,000 to $10,000 the maximum amount that may be deposited into a cafeteria plan on behalf of a participating retired state employee who has unused vacation, sick, or personal days.

Mr. Bob Brown and Mr. Dave Larsen both commented that currently many state employees planning to retire "burn" or otherwise use their accumulated leave days immediately before retiring. Ms. Cordelia Lewis stated that she would attempt to take a survey to determine how many employees would be affected by such an increase in the maximum amount that may be contributed to a cafeteria plan. (See Exhibit N, PD 3323.)

XIV. CMVA Request Concerning Military Service Credit.

Mr. Gohmann, attorney for the Commission, explained that the Commission on Military and Veterans Affairs (CMVA) had considered recommending legislation to either: (1) provide military service credit to PERF or TRF members; or (2) allow those members to purchase military service credit. Mr. Gohmann stated that the CMVA had voted to request the Pension Management Oversight Commission to consider PD 3288, which would allow members of PERF and TRF to purchase service credit at actuarial cost for military service not eligible for credit under existing PERF or TRF provisions. (See Exhibit O, PD 3288.)

XV. Next Meeting Date

The next meeting of the Commission was set for October 24 at the State House. Representative Kromkowski stated that this would be the Commission's last meeting for the interim. There being no further business, he adjourned the meeting at approximately 12:15 p.m.